REPORT OF EXAMINATION
OF THE

ASSOCIATED INDEMNITY CORPORATION

AS OF
DECEMBER 31, 2003

Participating States
and Zones:

California
New Jersey, Zone I – Northeastern

Filed June 24, 2005

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San Francisco, California
April 1, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable Julie M. Bowler
Secretary, Zone I-Northeastern
Commissioner of Insurance
Massachusetts Department of Insurance
Boston, Massachusetts

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

ASSOCIATED INDEMNITY CORPORATION

(hereinafter also referred to as the Corporation) at its home office located at 777 San Marin Drive, Novato, California 94998.

SCOPE OF EXAMINATION

The previous examination of the Corporation was made as of December 31, 1999. This examination covers the period from January 1, 2000 through December 31, 2003. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. An examiner from the State of New Jersey, representing Zone I, participated in this examination. The examination included a review of the Corporation's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

The Corporation is a participant in an intercompany reinsurance agreement with nine of its affiliates (hereinafter also referred to as the "participants"). The lead insurer is Fireman's Fund Insurance Company (FFIC). Under the terms of this agreement, the participants cede, and FFIC assumes, 100% of the participants' business generated from underwriting operations. The cessions from the participants are combined with the FFIC's business, resulting in the pooled balance to be allocated to each participant; consequently, in order to examine the Corporation's assets and liabilities that resulted from pooling, it was necessary to review this pooled balance.

The following affiliates participated in the intercompany reinsurance agreement at December 31, 2003:

Company
The American Insurance Company (Nebraska)
National Surety Corporation (Illinois)
American Automobile Insurance Company (Missouri)
Associated Indemnity Corporation (California)
Fireman's Fund Insurance Company of Ohio (Ohio)
Interstate Fire & Casualty Company (Illinois)
Chicago Insurance Company (Illinois)
Interstate Indemnity Company (Illinois)
Fireman's Fund Insurance Company of Wisconsin (Wisconsin)

All of the above companies were examined concurrently by their respective States of domicile.

In addition to those items specifically commented upon in this report, other phases of the Corporation's operations were reviewed including the following areas that require no further comment: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

EVENTS OF SEPTEMBER 11, 2001

Fireman's Fund Insurance Group reported $71 million in gross property and casualty losses through December 31, 2003 from the terrorist attacks on the World Trade Center in New York on September 11, 2001. Of this amount, a total of $26.95 million was ceded to third party reinsurers.

The Corporation evaluated its non-insurance losses with respect to the terrorist attacks on the World Trade Center and determined that nearly all such losses were fully insured through third-party insurers.

COMPANY HISTORY

The Corporation began business in 1923 as the Associated Industries Insurance Corporation. In 1927, the Corporation's name was changed to Associated Indemnity Corporation.

The Corporation is a wholly-owned subsidiary of American Automobile Insurance Company (AIC), which in turn is a wholly-owned subsidiary of Fireman's Fund Insurance Company (FFIC).

Capitalization

The Corporation is authorized to issue 500,000 shares of common stock with a par value of $40 per share. As of December 31, 2003, there were 87,500 shares outstanding.

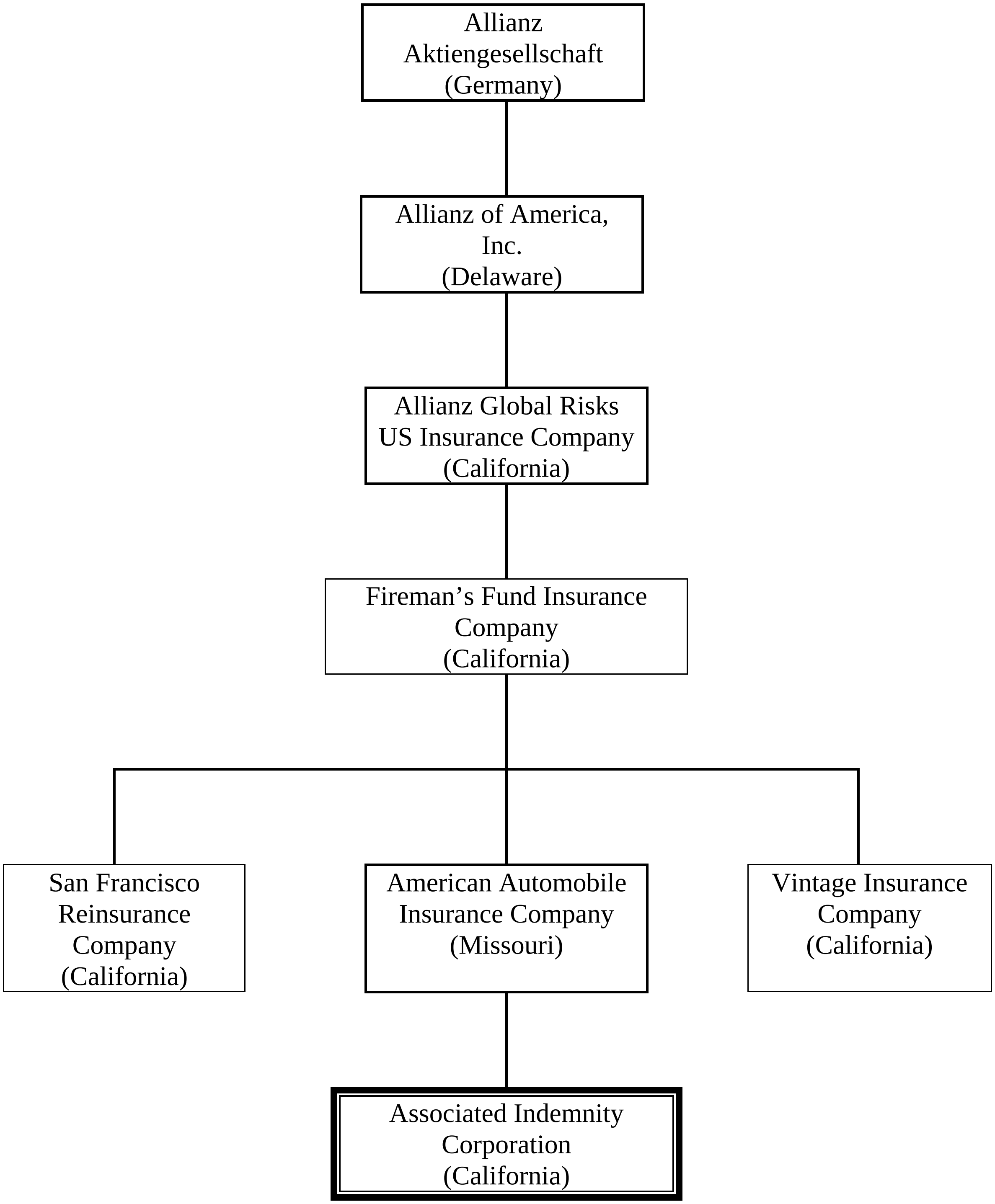
On December 31, 2002, the Corporation received a commitment for a capital contribution from its parent, American Automobile Insurance Company, in the amount of $10.4 million. This capital contribution commitment was settled in cash on February 15, 2003.

Restructuring Program

In April 2001, Fireman's Fund Insurance Group underwent significant restructuring. As a result of the restructuring program, the group discontinued writing new business in national accounts, Firemen's Fund direct, diversified risk, and surety segments. Additionally, the restructuring resulted in a change from two divisions – commercial and personal - to five business units.

MANAGEMENT AND CONTROL

The Corporation is a member of an insurance holding company system. Allianz Aktiengessellschaft (Allianz AG), a corporation organized in Munich, Germany, is the ultimate controlling entity. The chart on the following page depicts the interrelationship of the Corporation and its California affiliates within the holding company system (all ownership is 100%):


Allianz Aktiengesellschaft (Germany)
Allianz of America, Inc. (Delaware)
Allianz Global Risks US Insurance Company (California)
Fireman's Fund Insurance Company (California)
San Francisco Reinsurance Company (California)
American Automobile Insurance Company (Missouri)
Vintage Insurance Company (California)
Associated Indemnity Corporation (California)

The board of directors, which was comprised of six members, manages the business and affairs of the Corporation. Following are members of the board of directors and principal officers of the Corporation serving at December 31, 2003:

Directors

Name and Residence	Principal Business Affiliation
Peter Huehne (a) Tiburon, California	Executive Vice President and Chief Financial Officer Fireman's Fund Insurance Company
Janet S. Kloenhamer Larkspur, California	Senior Vice President, General Counsel and Corporate Secretary Fireman's Fund Insurance Company
H. David Lundgren Tiburon, California	Executive Vice President Fireman's Fund Insurance Company
Thomas E. Geissler Mill Valley, California	Executive Vice President Fireman's Fund Insurance Company
Jeffrey H. Post (b) Novato, California	President and Chief Executive Officer Fireman's Fund Insurance Company
Alastair C. Shore Novato, California	Senior Vice President Fireman's Fund Insurance Company

(a) Appointed CFO of Allianz of America (AZOA) effective January 1, 2004. Peter W. Presperin was appointed CFO of the Company effective January 1, 2004. Prior to this appointment, Mr. Presperin was the Director of Discontinued Operations at FFIC. He resigned as CFO of the Company in October 2004 and was replaced by Jill Patterson.

(b) Resigned in May, 2004 and was replaced by Charles Kavitsky, who previously held the position as President of Allianz Life Insurance Company.

Principal Officers

Name	Title
Jeffrey H. Post (a)	Chairman of the Board, President and Chief Executive Officer
Peter Huehne (b)	Executive Vice President and Chief Financial Officer
Janet S. Kloenhamer	Senior Vice President, General Counsel and Corporate Secretary
Linda E. Wright	Senior Vice President and Treasurer

(a) Resigned in May, 2004 and was replaced by Charles Kavitsky, who previously held the position as President of Allianz Life Insurance Company.

(b) Appointed CFO of Allianz of America (AZOA) effective January 1, 2004. Peter W. Presperin was appointed CFO of the Company effective January 1, 2004. Prior to this appointment, Mr. Presperin was the Director of Discontinued Operations at FFIC. He resigned as CFO of the Company in October 2004 and was replaced by Jill Patterson.

Management Arrangements

Tax Reimbursement Agreement: Effective December 17, 1999, the Corporation entered into a Tax Reimbursement Agreement for the purpose of clarifying an agreement that was in effect since 1991. The Tax Reimbursement Agreement was between Allianz of America, Inc. (AZOA) and the Corporation and its affiliates. Under this agreement, the tax liability of the Corporation and its afiliates will be computed as if each member filed a separate stand-alone return. AZOA is the party primarily responsible for filing and making all tax payments on behalf of the Corporation and its subsidiaries.

Investment Management Services Agreement: Effective January 1, 1981, the Corporation and several of its affiliates, entered into an investment management services agreement with Fireman's Fund Insurance Company (FFIC). This agreement has been amended on numerous occasions to add or remove affiliates as a party to the agreement. Under the provisions of the agreement, FFIC agrees to supply investment management services to the other parties. In consideration, the other parties agree to share the costs of furnishing the above investment management services.

TERRITORY AND PLAN OF OPERATION

The Corporation is licensed to transact insurance in all states of the United States and in the District of Columbia.

Under terms of the intercompany reinsurance agreements, in effect since January 1, 1966 (with the current agreements in effect since January 1, 1999), most of the underwriting transactions of the Corporation are pooled, reapportioned and then distributed to the ten members of the pool, as discussed under the caption “Reinsurance.”

The Corporation conducts its operations jointly with Fireman’s Fund Insurance Company (FFIC) through its home office in Novato, California. Multiple line operations are conducted nationwide through an extensive network of field and service offices. Each field office contains facilities for production, underwriting, claims, loss control, and premium auditing.

FFIC and its subsidiaries rank among the largest insurance groups domiciled in the United States. In 2003, the Group produced $4.1 billion of direct premiums through approximately 3,700 agents. The Group writes all lines of property and casualty business through five business units: Commercial, Personal, Marine, Interstate, and Agribusiness.

The Group also participates in underwriting pools, syndicates, associations, exchanges, and various state Fair Plans, including business underwritten or serviced by the American Cargo War Risk, the American Hull Insurance Syndicate, the American Nuclear Insurers, the Associated Aviation Underwriters, the Industrial Risk Insurers, and the Cargo Reinsurance Association.

In 2003, 26 percent of the Group’s direct premiums were written in California. The following five states accounted for an aggregate of another 27 percent of premiums written: New York, 9 percent; Florida, 5 percent; Texas, 5 percent; New Jersey, 4 percent; and Illinois, 4 percent.

REINSURANCE

Intercompany Reinsurance Agreement

The Corporation is a participant in an intercompany reinsurance agreement (agreement) with nine of its affiliates (hereinafter also referred to as the “participants”). The lead insurer is Fireman’s Fund Insurance Company (FFIC). Under the terms of this agreement, the participants cede, and FFIC assumes, 100% of the participants’ business generated from underwriting operations, as though the policies had been issued by FFIC. The cessions from the participants are combined with FFIC’s business, resulting in the pooled balance to be allocated to each company in the pool.

The following table illustrates each participant’s pooled share as of December 31, 2003:

Company	State of Domicile	Pooling Share
Fireman’s Fund Insurance Company	CA	75.0%
The American Insurance Company	NE	11.5%
National Surety Corporation	IL	4.0%
American Automobile Insurance Company	MO	2.5%
Associated Indemnity Corporation	CA	1.0%
Fireman’s Fund Insurance Company of Ohio	OH	0.2%
Interstate Fire & Casualty Company	IL	3.5%
Chicago Insurance Company	IL	1.5%
Interstate Indemnity Company	IL	0.8%
Fireman’s Fund Insurance Company of Wisconsin **	WI	0.0%
Total		100.0%

**effective January 1, 2003, the agreement was amended to change FFIC of Wisconsin’s share of the retrocession from 0.1% to 0.0% and the Company’s share from 74.9% to 75.0%.

Effective January 1, 1999 the agreement was revised and expanded to consolidate two separate pools into a single pool. Other subsidiaries of FFIC, referred to as “Specialty Companies,” cede 100% to the pool, but do not assume any portion of the pooled balances. These companies receive a commission from FFIC, and also pay a management fee, resulting in minimal income.

Three companies in the pool - Interstate Fire and Casualty Company, Interstate Indemnity Company and Chicago Insurance Company - submit business to the pool net of reinsurance arrangements with third parties.

The agreement authorizes and empowers FFIC to: (1) collect and receive all premiums; (2) adjust and pay all losses; (3) reinsure or cancel any and all policies and contracts of insurance; and (4) act as though the policies and contracts of insurance and reinsurance were issued by FFIC. It further provides for the complete sharing of all income and expenses of the pooled business with the exception of the investment operations, dividends to policyholders, liabilities for federal income tax or other items not relating to the underwriting operations of the parties. Accounts are required to be settled quarterly.

Assumed

The Corporation does not assume reinsurance from third parties.

Ceded

Reinsurance, other than intercompany, is placed by FFIC for the Fireman's Fund Insurance Companies' Group (Group). All members of the Group, either individually or collectively, may utilize the reinsurance of the various contracts that are in effect.

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review was made of the Corporation's general controls over its information systems. As the result of this review, recommendations for improving the Corporation's information systems controls were developed and presented to the Corporation. The recommendations covered areas such as logical security, physical security and program changes.

The Corporation should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Reconciliation of General Ledger Accounts

During the review of the Corporation's reconciliation of certain general ledger accounts, it was noted that the Corporation relied on a sub-ledger balance as an acceptable form of supporting documentation without reconciling the sub-ledger balance to the detail. The Corporation also used e-mail as supporting documentation, although less common. It is recommended that the Corporation implement controls to ensure that general ledger accounts are reconciled to the system from which the data feeding the general ledger resides.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders from December 31, 1999 through December 31, 2003

Reconciliation of Examination Changes as of December 31, 2003

Statement of Financial Condition
as of December 31, 2003

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 96,414,061	$	$ 96,414,061	(1)
Common stocks	0		0	(2)
Other invested assets	7,786,718		7,786,718	(2)
Investment income due and accrued	1,182,401		1,182,401	
Premiums and agents' balances in course of collection	5,552,512	824,578	4,727,934	
Deferred premiums, agents' balances and installments booked but deferred and not yet due	3,378,105	16,509	3,361,596	(3)
Accrued retrospective premiums	75,085	14,496	60,589	
Net deferred tax asset	7,769,806	5,186,763	2,583,043	
Receivable from parent, subsidiaries and affiliates	943,066		943,066	
Other assets nonadmitted	64,562	2,110	62,452	
Total assets	$ 123,166,316	$ 6,044,456	$ 117,121,860	

Liabilities, Surplus and Other Funds			Notes
Losses		$ 46,591,743	(4)
Loss adjustment expenses		9,108,257	(4)
Commissions payable, contingent commissions and other similar charges		1,153,258	
Other expenses		700,359	
Taxes, licenses and fees		600,481	
Unearned premiums		17,911,299	
Advance premiums		(991)	
Dividends declared and unpaid: Policyholders		74,886	(5)
Aggregate write-ins for liabilities		72,690	
Total liabilities		76,211,982	
Common capital stocks	$ 3,500,000		
Gross paid-in and contributed surplus	13,005,856		
Unassigned funds (surplus)	24,404,022		
Surplus as regards policyholders		40,909,878	
Total liabilities, surplus and other funds		$ 117,121,860	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2003

Statement of Income

Underwriting Income		
Premiums earned		$38,926,976
Deductions:		
Losses incurred	$27,773,019	
Loss expenses incurred	6,013,555	
Other underwriting expenses incurred	12,545,485	
Total underwriting deductions		46,332,059
Net underwriting loss		(7,405,083)
Investment Income		
Net investment income earned	$ 5,440,336	
Net realized capital gains	828,057	
Net investment gain		6,268,393
Other Income		
Net loss from agents' or premium balances charged off	$ (80,140)	
Aggregate write-ins for miscellaneous income	(2,459)	
Total other income		(82,599)
Net loss before dividends to policyholders and before federal and foreign income taxes		(1,219,289)
Dividends to policyholders		51,622
Federal and foreign income taxes incurred		(563,145)
Net loss		$ (707,766)

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002		$40,131,529
Net loss	$ (707,766)	
Change in net unrealized capital gains	343,945	
Change in net unrealized foreign exchange capital loss	(339)	
Change in net deferred income tax	6,789,806	
Change in nonadmitted assets	5,647,297)	
Change in surplus as regards policyholders		778,349
Surplus as regards policyholders, December 31, 2003		$40,909,878

Reconciliation of Surplus as Regards Policyholders
from December 31, 1999 through December 31, 2003

Surplus as regards policyholders, December 31, 1999 per Examination			$40,508,694
	Gain in Surplus	Loss in Surplus	
Net loss	$	$12,213,667	
Change in net foreign exchange capital gains	3,553		
Change in net deferred income tax	5,148,806		
Change in nonadmitted assets		4,644,883	
Cumulative effect of changes in accounting principles	1,707,375		
Surplus adjustments: Paid-in	10,400,000		
Total gains and losses	$17,259,734	$16,858,550	
Net decrease in surplus as regards policyholders			401,184
Surplus as regards policyholders, December 31, 2003, per Examination			$40,909,878

Reconciliation of Examination Changes
as of December 31, 2003

	Per Company	Per Examination	Surplus Increase (Decrease)	Notes
Assets				
Common Stocks	$ 7,786,718	$ 0	$ (7,786,718)	(2)
Other invested assets	0	7,786,718	7,786,718	(2)
Liabilities				
Losses and loss adjustment expenses	49,601,896	55,700,000	(6,098,104)	(4)
Dividends declared and unpaid: Policyholders	36,070	74,886	(38,816)	(5)
Net decrease to surplus			(6,136,920)	
Surplus as regards policyholders, December 31, 2003, per Corporation			47,046,798	
Surplus as regards policyholders, December 31, 2003, per Examination			$40,909,878	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

The Custodian Agreement (Agreement) dated October 1, 1998 between the Corporation and Mellon Trust of California does not adhere to the guidance regarding Custodial and Safekeeping Agreements provided by the National Association of Insurance Commissioners' Financial Examiners Handbook in the following areas:

a) The Agreement states: "At its option, the Custodian may commingle any assets deposited hereunder with assets held by the Custodian on behalf of others". The agreement should clearly state that certificated securities of the insurance company shall be held separate from all other securities or in a fungible bulk. Those securities held in a fungible bulk by the custodian, in a clearing corporation, or in the Federal Reserve book-entry system, shall be separately identified on the custodian's official records as being owned by the insurance company.

b) The Agreement did not contain a clause requiring that should the Agreement be terminated, or if 100% of the account assets in any one custody account are withdrawn, the custodian shall provide written notification, within three business days of the termination or withdrawal, to the insurer's domiciliary commissioner.

c) The Agreement did not contain a clause requiring that the custodian and its agents, upon reasonable request, be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system that the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control.

d) The Agreement did not contain a clause requiring that the custodian secure and maintain insurance protection in an adequate amount.

It is recommended the Corporation revise its Custodian Agreement with Mellon Trust of California to include provisions recommended by the National Association of Insurance Commissioners' Financial Examiners Handbook. It is also recommended the Corporation submit the revised Agreement to the California Department of Insurance (CDI) for approval.

(2) Common Stocks and Other Invested Assets

The Corporation classified Allianz Cash Pool LLC, a limited liability company, as common stock and reported it on Schedule D, Part 2, Section 2. SSAP No. 48, paragraph 6 of the NAIC Accounting Practices and Procedures Manual specifies that investments in joint ventures, partnership and limited liability companies be reported on Schedule BA, Other Invested Assets. The value of the Allianz Cash Pool LLC at December 31, 2003 was $7,786,718. This asset has been reclassified to Other Invested Assets per examination. It is recommended that the Corporation classify Allianz Cash Pool, LLC as Other Invested Assets and report it in Schedule BA.

(3) Deferred Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due

Members of the intercompany reinsurance pool ceded deferred premiums to the lead insurer, Fireman's Fund Insurance Company (FFIC), but FFIC did not retrocede the members' portion of the pooled balance back to the member. The pooled balance of such deferred premium amounted to $18,844,032, of which $883,367 was allocated to the Corporation. No examination change was made, as the offsetting entry is to inter-company receivables. It is recommended the Corporation implement controls to ensure that all accounts subject to pooling are properly pooled and allocated to each member.

(4) Losses and Loss Adjustment Expenses

The CDI, pursuant to California Insurance Code (CIC) Section 733(g), retained a consulting actuary for the purpose of providing a full actuarial evaluation of the Corporation's loss and loss adjustment expense reserves as of December 31, 2003. Based on the analyses performed by the CDI's consulting actuary, it was determined that the range of probable loss and loss adjustment expense reserve estimates varied from a low of $5,009,000,000 to a high of $6,121,800,000. This is the range estimate for all companies participating in the inter-company reinsurance agreement. The CDI has determined its best estimate of loss and loss adjustment expense reserves to be $5,565,100,000, which reflects a reserve deficiency of $604,910,000. The Corporation's share of this deficiency totals $6,098,104.

(5) Dividends Declared and Unpaid – Policyholders

The Corporation did not accrue a payable for policyholder dividends when the dividends were declared. Policyholder dividends of $3,881,608 were declared in December, 2003, but not recorded by the Corporation until May, 2004. As a pooled account, 1% of the declared dividend, or $38,816 is allocated to the Corporation. Accordingly, an examination adjustment was made for this amount. It is recommended that the Corporation record policyholder dividends payable in the period in which they are declared.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records – Information System Controls (Page 10): As the result of our review of the Corporation's information systems controls, recommendations for improving these controls were presented to the Corporation. The Corporation should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Accounts and Records – Reconciliation of Key General Ledger Accounts (Page 11): It is recommended that the Corporation implement controls to ensure that general ledger accounts are reconciled to the system from which the data feeding the general ledger resides.

Comments on Financial Statement Items – Bonds (Page 16): It is recommended the Corporation revise its Custodial Agreement with Mellon Trust of California to include provisions recommended by the NAIC Financial Examiners Handbook. It is also recommended the Corporation submit the revised Agreement to the California Department of Insurance (CDI) for approval.

Comments on Financial Statement Items – Common Stocks and Other Invested Assets (Page 17): It is recommended that the Corporation classify Allianz Cash Pool, LLC as Other Invested Assets and report it in Schedule BA.

Comments on Financial Statement Items – Deferred Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due (Page 17): It is recommended the Corporation implement controls to ensure that all accounts subject to pooling are properly pooled and allocated to each member.

Comments on Financial Statement Items – Dividends declared and unpaid – Policyholders (Page 18): It is recommended that the Corporation record policyholder dividends payable in the period in which they are declared.

Previous Report of Examination

Accounts and Records - (Page 13): It was recommended the Corporation institute policies and procedures to analyze and evaluate general ledger accounts on a regular basis. The Corporation performed a review of general ledger accounts and implemented controls to ensure that the general ledger accounts are reviewed and reconciled on a timely basis.

Comments on Financial Statement Items - Bonds, Stocks and Short-Term Investments (Page 17): It was recommended the Corporation obtain approval from the CDI of its Custodial Agreement with the Mellon Bank of California. The current custodial agreement did not contain provisions recommended by the NAIC Financial Examiners Handbook. Accordingly, it is recommended the Corporation submit the revised Agreement to the CDI for approval.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Corporation's officers and employees during the course of this examination.

Respectfully submitted,

/S/

Gordon M. Curtis, CFE, CISA
Examiner-In-Charge
Department of Insurance
State of California

/S/

Dennis Kluk, CFE
Representing New Jersey Department
of Banking and Insurance
State of New Jersey
Representing Zone I – Northeastern, NAIC